Daiwa Capital Markets

U.S. Economic Comment

- Inflation: modest improvement in April from disappointing Q1 results
- The consumer sector: evidence of slowing demand and some signs of stress

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Inflation Pressure Subsides (to a Degree)

Price data this week signaled for the first time in 2024 that inflation may again be moderating after a rapid increase in Q1. Both the PPI (Tuesday) and CPI (Wednesday) provided some reason for optimism on this front, although we still view rate cuts as unlikely until at least the fall. However, while an easing in the current stance of monetary policy is not imminent, the latest data lessen the probability that Fed officials will have to abandon their easing bias and pivot back to hiking the target range for the federal funds rate. Rather, as Chair Powell argued on Tuesday at an event hosted by Netherlands' Foreign Bankers' Association, “we’ll need to be patient and let restrictive policy do its work.”

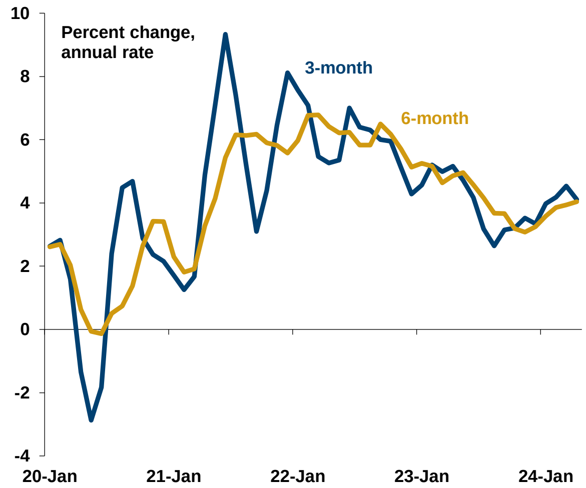
The April Data in Context

On the surface, the 0.3 percent (0.29 percent with less rounding) increase in the core CPI in April was broadly similar to unfavorable readings in Q1 (average monthly advance of 0.37 percent). Commodity prices excluding food and energy fell 0.1 percent (-1.3 percent year-over-year), but service prices excluding food and energy, the ongoing source of inflationary pressure, jumped 0.4 percent (+5.3 percent year-over-year). Three and six-month annualized growth rates of 4.1 percent and 4.0 percent, respectively, for the core CPI were similar to those of 4.5 percent and 3.9 percent in March and still well above December 2023 readings (3.3 percent and 3.2 percent, respectively; chart, right).

Importantly, however, hints of deceleration in various elements of the CPI and additional evidence from the PPI report allowed for a more favorable interpretation of the latest consumer inflation data and raised the possibility of a 0.2 percent reading on the core price index for personal consumption expenditures (the FOMC’s preferred inflation gauge) to be released on May 31. We still suspect that the core price index will round up to 0.3 percent, but the April reading should be improved from the monthly average of 0.36 in Q1 (chart).

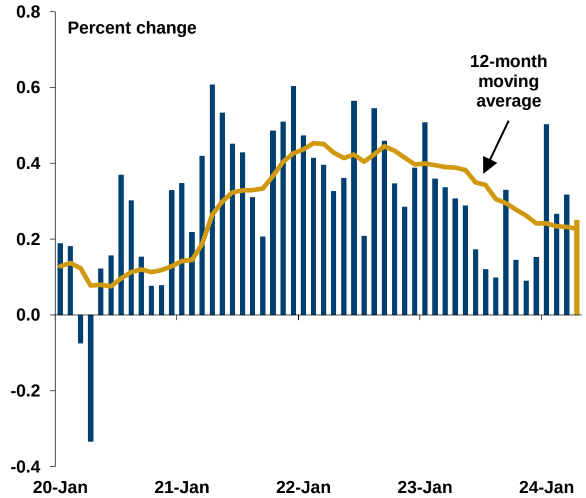
With respect to specific components of this week’s reports, we were firstly encouraged by the housing-related components of the CPI, which have made a sizable contribution to the ongoing bout of price pressure. Both the rent of primary residence and owners’ equivalent rent components rounded to 0.4 percent in April (0.35 and 0.42 percent, respectively), but they slowed from monthly averages of 0.41 percent and 0.48 percent in Q1 and

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

Core PCE Price Index*

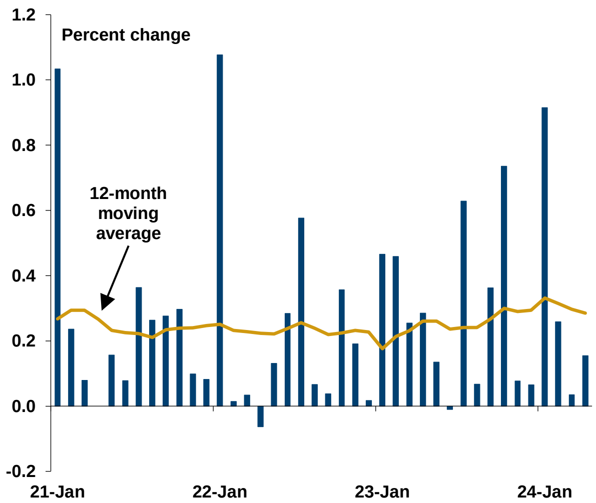


** The gold bar is a forecast of 0.25% for April 2024.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America contrasted sharply with peak monthly advances of 0.8 percent for primary rents and 0.7 percent for OER (reached at various points in 2022). It appears that the reversion in market rent inflation to the pre-pandemic trend has begun to exert a more forceful influence on consumer inflation metrics, albeit after a long lag associated with both survey structure and lease renewal dynamics.

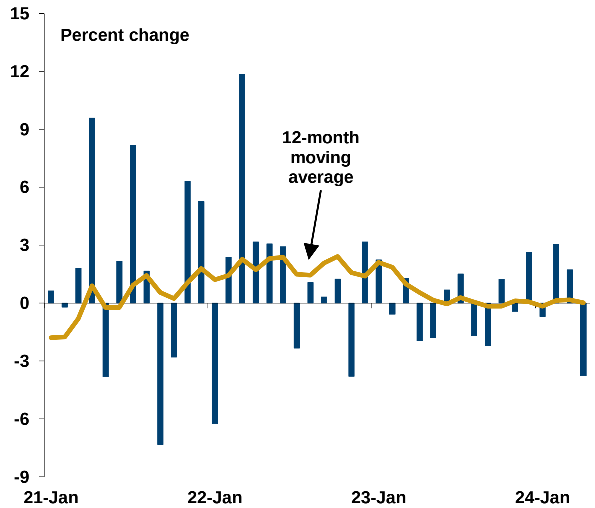
We also would draw attention to the healthcare services and airline passenger services components of Tuesday's PPI report, which inform our expectations for elements of the PCE price index (charts, below). The latest increase in health care services of 0.2 percent lagged that in the health care services component of the CPI (+0.4 percent), while the drop of 3.8 percent in airline passenger services far exceeded the decline of 0.8 percent in the airline fares component of the CPI, but the PPI data in these instances are salient when assessing effects on the PCE index. Thus, the relationship between elements of the PPI and PCE indexes is imperfect, but it does help to shape expectations – and in this case it suggests slower core inflation than in recent months. Again, such a development would likely not give Fed officials the required confidence to begin cutting the target range for the federal funds rate in the near-term, but it could give credence to the view that the acceleration in inflation in Q1 represented a pause in progress toward two percent inflation rather than a turn higher. That said, and as noted by officials on numerous occasions, one positive reading doesn't indicate a trend. What the FOMC needs to see is several months of inflation moving back towards target, although April could be the start of renewed deceleration.

PPI: Health Care Services*



** Not seasonally adjusted*
Source: Bureau of Labor Statistics via Haver Analytics

PPI: Airline Passenger Services



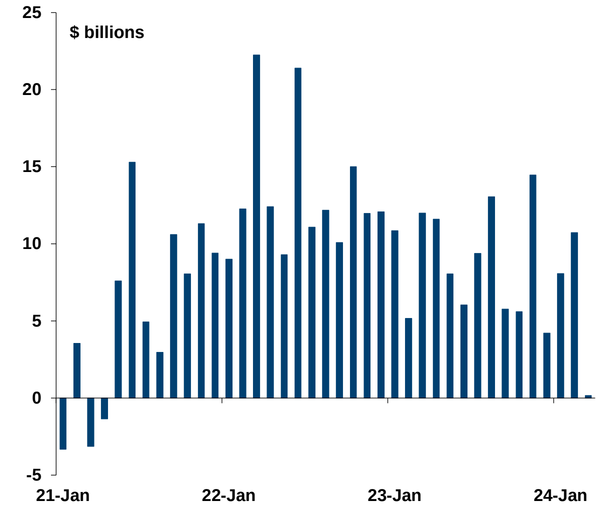
Source: Bureau of Labor Statistics via Haver Analytics

Consumer Spending Slows in April

In remarks delivered on Thursday, President Loretta Mester of the Cleveland Fed (a 2024 voter who is retiring at the end of June) commented at length on the Fed's ongoing fight against inflation and offered a guarded assessment of recent developments. Of note, she indicated that she viewed the disinflationary impulse of "healing" on the supply side of the economy as having run its course. Further progress, she argued, would be contingent on "moderating demand."

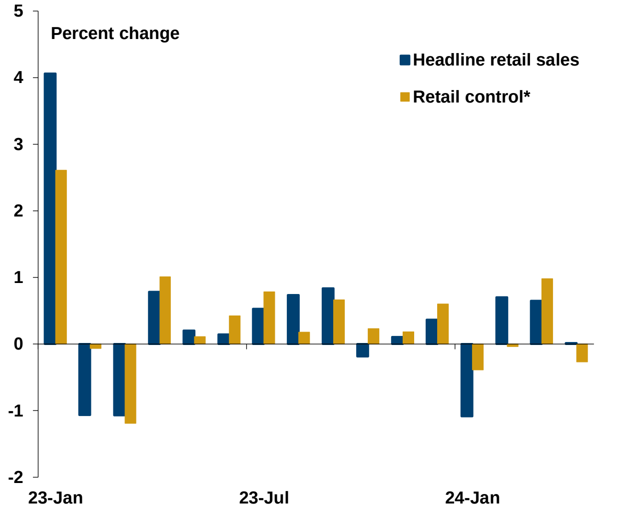
Evidence of the required easing on the demand side of the economy was present in several recent reports on the consumer sector. Last week's release on consumer credit showed that growth of revolving credit (i.e. credit card debt) stalled in March after brisk growth of 8.9 percent, annual rate, in the opening two months of the year, with the formerly brisk growth rate essentially matching that in 2023 (chart, next page, left). That slowdown dovetailed with a sluggish retail sales report this week and suggested that consumer outlays hit an air pocket in early Q2. In particular, we were struck by the decline of 0.3 percent in the so-called retail control, which correlates with goods spending in the GDP accounts (chart, next page, right).

Revolving Consumer Credit



Source: Federal Reserve Board via Haver Analytics

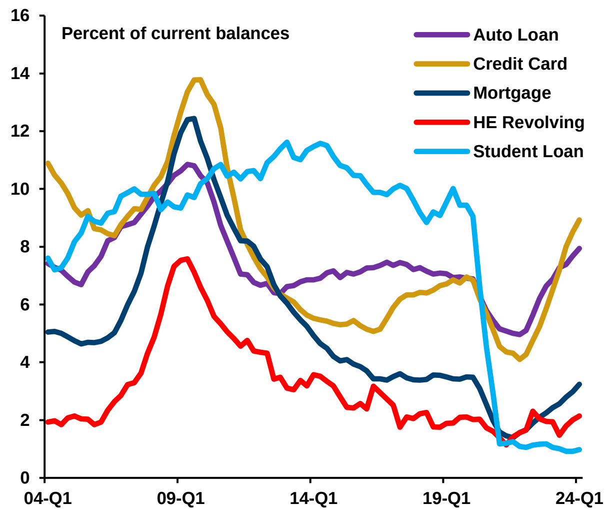
Retail Sales



** Retail sales excluding sales from motor vehicle dealers, gasoline stations, and building materials, garden equipment, and supply dealers.*
Source: U.S. Census Bureau via Haver Analytics

The slowdown could be interpreted favorably on the inflation front, provided it does not portend a rapid deterioration in underlying fundamentals. If demand needs to ease further to bring inflation back to two percent, then a moderation in consumer spending is a welcome development. That said, officials also have noted that moderation in economic activity needs to occur in an orderly fashion for it to be beneficial to the central bank's dual mandate of maximum employment (which requires a generally healthy economy) and price stability.

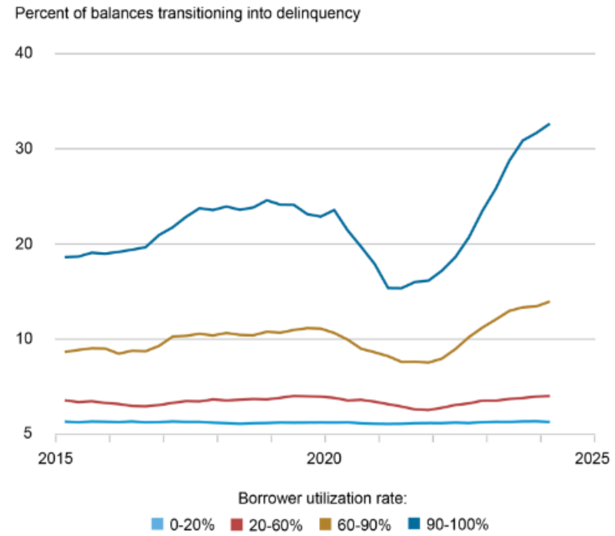
Transition into Delinquency by Loan Type*



** New delinquent balances, 30+ days past due*
Source: Household Debt & Credit Report, Federal Reserve Bank of New York via Haver Analytics

In this regard, we note with some concern data from the New York Fed's Household Debt and Credit Report for Q1. The latest survey revealed increasing delinquencies in credit card and auto loans and more recent trouble emerging in mortgage debt (chart, right). Providing analysis on a subset of the data, economists from the New York Fed in a note this week focused on credit card borrowing in particular for those with maxed-out credit lines (see: Haughwout, Andrew F. et al. "Delinquency Is Increasingly in the Cards for Maxed-Out Borrowers," Federal Reserve Bank of New York Liberty Street Economics, May 14, 2024. https://libertystreeteconomics.newyorkfed.org/2024/05/delinquency-is-increasingly-in-the-cards-for-maxed-out-borrowers). Their research indicated that those with higher borrower utilization rates (as a share of credit lines) were transitioning into delinquency at a higher rate than observed prior to the pandemic and, moreover, an increasing share of credit card borrowers were maxing out their credit cards (exhausting credit lines; charts, next page). However, while the authors concluded that the developments were unwelcome, they also indicated that macroeconomic conditions would dictate whether or not delinquencies would deteriorate further. With that in mind, the calculus of Fed officials on rates comes into clearer focus. Restrictive monetary policy is required to achieve a slowing in inflation, but higher rates for longer will magnify stresses in the economy over time and possibly lead to undesirable outcomes. Consequently, the critical element is to identify when slowing demand transitions into negative (and possibly disorderly) developments for the U.S. economy.

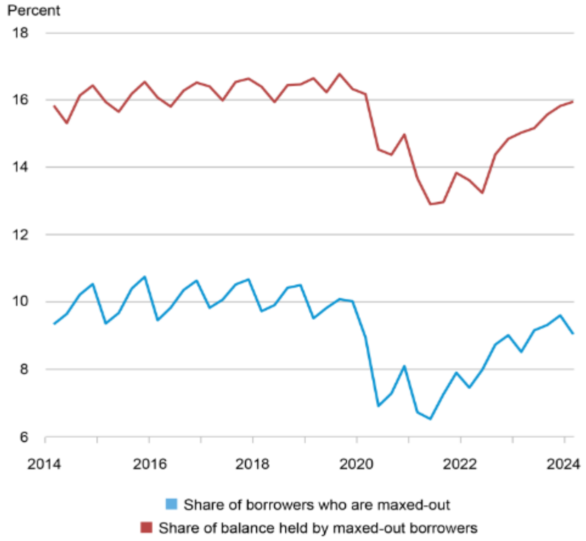
Credit Card Delinquencies*



** The chart shows balance-weighted transition to credit card delinquency among borrowers who were current on all credit card accounts in the previous quarter. A borrower's utilization group is determined by their utilization in the previous quarter. Data are smoothed as four-quarter moving sums to account for seasonal trends.*

Source: Haughwout, Andrew F. et al. "Delinquency Is Increasingly in the Cards for Maxed-Out Borrowers," Federal Reserve Bank of New York Liberty Street Economics, May 14, 2024. https://libertystreeteconomics.newyorkfed.org/2024/05/delinquency-is-increasingly-in-the-cards-for-maxed-out-borrowers/

Share of Maxed-Out Credit Card Borrowers*



** Maxed-out denotes borrowers who have 90 percent or higher utilization across all credit cards. Delinquent borrowers and balances are excluded. Data are not smoothed and reflect seasonal patterns.*

Source: Haughwout, Andrew F. et al. "Delinquency Is Increasingly in the Cards for Maxed-Out Borrowers," Federal Reserve Bank of New York Liberty Street Economics, May 14, 2024. https://libertystreeteconomics.newyorkfed.org/2024/05/delinquency-is-increasingly-in-the-cards-for-maxed-out-borrowers/

The Week Ahead

Existing Home Sales (April) (Wednesday)
Forecast: 4.25 Million (+1.4%)

Although housing affordability remains constrained by high prices, elevated mortgage rates, and low inventories, a pickup in the index of pending home sales in February and March raises the possibility of an increase in existing home sales in April. That said, the projected pace of activity would still be in the lower end of the longer-term range (chart).

(Note that existing home sales are based on closings; pending home sales, in most cases, close in one to three months.)

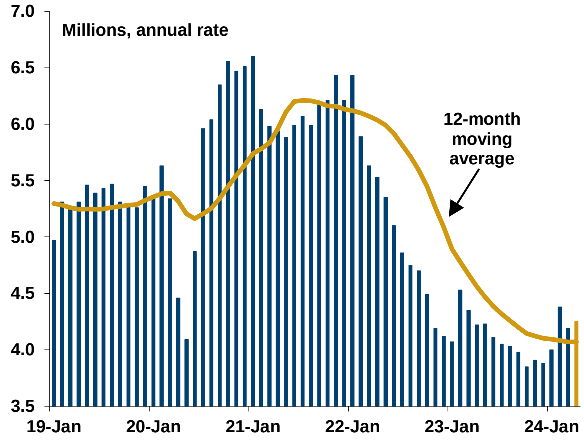
New Home Sales (April) (Thursday)
Forecast: 675,000 (-2.6%)

Dips in buyer traffic and mortgage applications for home purchases amid a pickup in mortgage interest rates in April suggest an easing in the pace of new home sales, which are based on contracts signed rather than closings. Even with the expected easing in April, the projected level of new home sales would be comparable to those in the upper end of the range of the previous expansion (2019, prior to the onset of COVID-related disruptions; chart). The housing market is constrained by tight financial conditions and elevated prices, but buyers have, in some cases, found more favorable opportunities in the new home segment, which has supported a relatively solid pace of activity.

Durable Goods Orders (April) (Friday)
Forecast: -0.5% Total, +0.2% Ex. Transportation

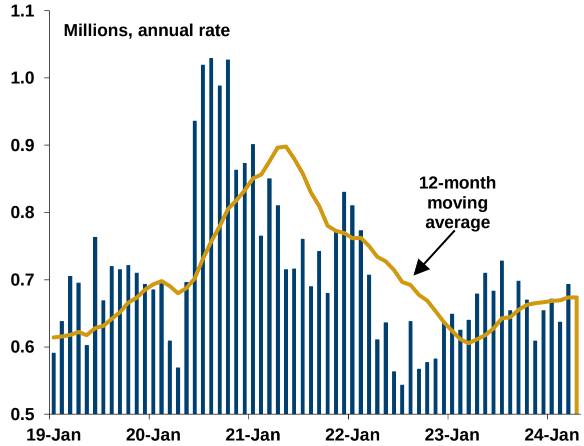
Headline durable goods orders are likely to be dragged lower by volatility in nondefense aircraft bookings, as ongoing quality control issues at Boeing led to net cancellations in new orders in April. Orders excluding transportation have increased in only two of the past six months, with the flat trend suggesting that restrictive monetary policy is continuing to constrain investment in capital equipment (chart).

Existing Home Sales*



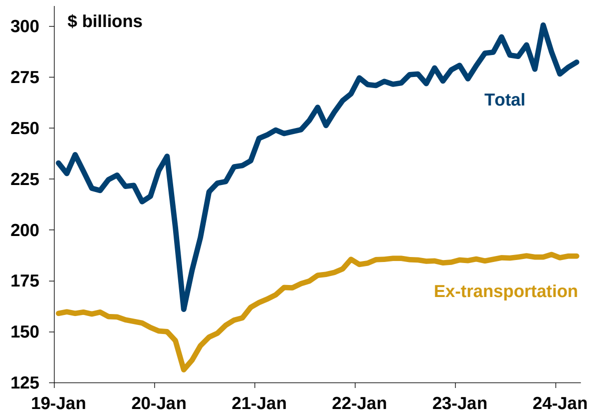
** The gold bar is a forecast for April 2024.*
Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

New Home Sales*



** The gold bar is a forecast for April 2024.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Economic Indicators

May/June 2024

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX Feb 89.4 Mar 88.5 Apr 89.7 **PPI** (Final Demand / Ex. Food & Energy) Feb 0.6% 0.3% Mar -0.1% -0.1% Apr 0.5% 0.5%	**CPI** (Total / Core) Feb 0.4% 0.4% Mar 0.4% 0.4% Apr 0.3% 0.3% **RETAIL SALES** (Total / Ex.Autos) Feb 0.7% 0.3% Mar 0.6% 0.9% Apr 0.0% 0.2% **EMPIRE MFG** Mar -20.9 Apr -14.3 May -15.6 **NAHB HOUSING INDEX** Mar 51 Apr 51 May 45 **BUSINESS INVENTORIES** (Inventories / Sales) Jan 0.0% -1.1% Feb 0.3% 1.4% Mar -0.1% -0.1% **TIC FLOWS** (Long-Term / Total) Jan $23.2B -$27.3B Feb $62.9B $42.0B Mar $100.5B $102.1B	**UNEMPLOYMENT CLAIMS** (Initial / Continuing (millions)) Apr 20 0.208 1.768 Apr 27 0.209 1.781 May 4 0.232 1.794 May 11 0.222 N/A **HOUSING STARTS** Feb 1.546 million Mar 1.287 million Apr 1.360 million **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Mar 3.2 Apr 15.5 May 4.5 **IMPORT/EXPORT PRICES** (Non-Petrol Imports / Nonagri. Exports) Feb 0.1% 0.7% Mar 0.1% 0.3% Apr 0.7% 0.7% **IP & CAP-U** (IP / Cap.Util.) Feb 0.8% 78.5% Mar 0.1% 78.5% Apr 0.0% 78.4%	**LEADING INDICATORS** Feb 0.2% Mar -0.3% Apr -0.6%
20	21	22	23	24
		EXISTING HOME SALES (10:00) Feb 4.380 million Mar 4.190 million **Apr 4.250 million** **FOMC MINUTES (2:00)**	**UNEMP. CLAIMS (8:30)** **CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** (Monthly / 3-Mo. Avg.) Feb 0.09 -0.28 Mar 0.15 -0.19 Apr -- -- **NEW HOME SALES (10:00)** Feb 0.637 million Mar 0.693 million **Apr 0.675 million**	**DURABLE GOODS ORDERS (8:30)** Feb 1.2% Mar 0.9% **Apr -0.5%** **REVISED CONSUMER SENTIMENT (10:00)** Mar 79.4 Apr 77.2 May(p) 67.4
27	28	29	30	31
MEMORIAL DAY	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**BEIGE BOOK**	**UNEMP. CLAIMS** **REVISED Q1 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **MNI CHICAGO BUSINESS BAROMETER**
3	4	5	6	7
ISM MFG. INDEX **CONSTRUCTION** **VEHICLE SALES**	**FACTORY ORDERS** **JOLTS DATA**	**ADP EMPLOYMENT** **ISM SERVICES INDEX**	**UNEMP. CLAIMS** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS**	**EMPLOYMENT REPORT** **WHOLESALE TRADE** **CONSUMER CREDIT**

Forecasts in bold. (p) = preliminary

Treasury Financing

May/June 2024

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
AUCTION RESULTS: Rate Cover 13-week bills 5.250% 2.77 26-week bills 5.165% 3.02	**AUCTION RESULTS:** Rate Cover 52-week bills 4.895% 3.00 42 day CMBs 5.280% 2.81 **ANNOUNCE:** $60 billion 17-week bills for auction on May 15 $80 billion 4-week bills for auction on May 16 $80 billion 8-week bills for auction on May 16 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.235% 2.98 **SETTLE:** $58 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 4-week bills 5.270% 2.73 8-week bills 5.270% 2.74 **ANNOUNCE:** $140 billion 13-,26-week bills for auction on May 20 $16 billion 20-year bonds for auction on May 22 $16 billion 10-year TIPS for auction on May 23 $75 billion 43-day CMBs for auction on May 21 **SETTLE:** $140 billion 13-,26-week bills $46 billion 52-week bills $75 billion 42-day CMBs	
20	21	22	23	24
AUCTION: $140 billion 13-,26-week bills	**AUCTION:** $75 billion 43-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on May 22 $80 billion* 4-week bills for auction on May 23 $80 billion* 8-week bills for auction on May 23 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $16 billion 20-year bonds	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $16 billion 10-year TIPS **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on May 28 $69 billion* 2-year notes for auction on May 28 $70 billion* 5-year notes for auction on May 28 $44 billion* 7-year notes for auction on May 29 $28 billion* 2-year FRNs for auction on May 29 **SETTLE:** $140 billion 13-,26-week bills $75 billion 43-day CMBs	
27	28	29	30	31
MEMORIAL DAY	**AUCTION:** $140 billion* 13-,26-week bills $69 billion* 2-year notes $70 billion* 5-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on May 29 $80 billion* 4-week bills for auction on May 30 $80 billion* 8-week bills for auction on May 30 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $44 billion* 7-year notes $28 billion* 2-year FRNs	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on June 3 **SETTLE:** $140 billion* 13-,26-week bills	**SETTLE:** $16 billion 20-year bonds $16 billion 10-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes $28 billion* 2-year FRNs
3	4	5	6	7
AUCTION: $140 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on June 5 $80 billion* 4-week bills for auction on June 6 $80 billion* 8-week bills for auction on June 6 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on June 10 $46 billion* 52-week bills for auction on June 11 $58 billion* 3-year notes for auction on June 10 $39 billion* 10-year notes for auction on June 11 $22 billion* 30-year bonds for auction on June 13 **SETTLE:** $140 billion* 13-,26-week bills	

**Estimate*